STATEMENT

of

Michael F. Petrie

on

H.R. 3755

"Zero Downpayment Act of 2004"

before the

Subcommittee on Housing and Community Opportunity

Committee on Financial Services

United States House of Representatives

March 24, 2003

Good morning, and thank you Mr. Chairman, for holding this hearing and inviting the Mortgage Bankers Association (MBA)[1] to share its views on H.R. 3755, the "Zero Downpayment Act of 2004," introduced on February 3, 2004. My name is Michael Petrie and I am President of P/R Mortgage & Investment Corp. (P/RMIC), Indianapolis, Indiana, chairman of Greensfork Township State Bank, Spartanburg, Indiana, and Chairman-Elect of the Mortgage Bankers Association (MBA).

The U.S. currently enjoys the highest rate of homeownership it has ever seen with 68.6% of households owning their own home. This is a tremendous accomplishment. More importantly though, behind this percentage rate are the more than 71 million families who are enjoying the fruits of homeownership. While this success means that more American families than ever before are enjoying the financial and social benefits of homeownership, there is still more to be done.

MBA would like to draw the attention of this subcommittee to the 31.4% of households that do not own their own home. Many of these families have made the decision to rent for very good reasons. MBA's multifamily members finance the properties that house these families and we have long advocated policies that assure a safe, decent and affordable supply of rental housing.

However, a large number of the 33 million renter families want to own their own home, but face significant challenges. These challenges include insufficient income, poor credit, lack of information, and the lack of funds for the downpayment.

Thus, while we may celebrate the U.S.'s record homeownership rate, that very same rate masks a glaring disparity: minorities have a much lower rate of homeownership than non-minorities, and low- and moderate-income families have a much lower rate of homeownership than those at or above median-income levels. In the 4th quarter of 2003, while 75.5% of Non-Hispanic White households owned their own homes, only 49.4% of Black households and 47.7% of Hispanic or Latino households owned their own homes. Additionally, while 83.2% of families earning more than the median income owned their own home, only 52.1% of families below the median income did. MBA believes these homeownership gaps are a problem.

Simply put: not all populations equally participate in the benefits of homeownership.

---

[1]The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 400,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership prospects through increased affordability; and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters excellence and technical know-how among real estate finance professionals through a wide range of educational programs and technical publications. Its membership of approximately 2,700 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, life insurance companies and others in the mortgage lending field. For additional information, visit MBA's Web site: www.mortgagebankers.org.
.

The gaps in homeownership rates are a result of several issues, and closing the homeownership gap will require several initiatives. H.R. 3755 deals directly with one prominent obstacle: the downpayment.

A March 2003 study conducted by the Mortgage Insurance Companies of America (MICA) found that the downpayment was identified by renters as the biggest hurdle to homeownership. Fifty-one percent of renters stated that coming up with enough money for the downpayment would be the biggest hurdle for them. This was more than double the next hurdle: making a long-term commitment to owning a home, which 19% of respondents identified.

The downpayment hurdle appears to be a significant issue for minorities. Several studies have identified the “wealth constraint” – that is the ability to save for a downpayment – as a major homeownership barrier for minority families. Practically by definition, the downpayment hurdle disproportionately affects low- and moderate-income families who may be able to make monthly housing payments without difficulty, but find it problematic to save for the downpayment.

MBA believes that in order to truly expand homeownership opportunities, we must overcome the downpayment challenge. We believe the FHA zero downpayment loan program is the appropriate tool for addressing this challenge.

In the past, the amount of downpayment was considered an indicator of credit risk, that is, the willingness and ability of a borrower to make monthly payments on a mortgage. The benchmark was (and still is) that a 20% downpayment on a home provides lenders sufficient comfort that a borrower has the ability to handle the mortgage. In addition to being an indicator of risk, a 20% downpayment also provided a buffer for lenders in case of default.

The Federal Housing Administration (FHA), in its 70-year history of mortgage innovation, began the trend to insure mortgages with less than a 20% downpayment, or conversely, to insure loans with a greater than 80% Loan-to-Value (LTV). Over the years, FHA has gradually and successfully lowered the amount of required downpayment. Today, FHA will insure a loan up to 97% of the value of a home, requiring the borrower to provide only a 3% downpayment.

Simultaneously, as downpayment requirements were lowered, advances were made in credit underwriting over the past 15 years, such as the emergence of Automated Underwriting Systems (AUS) and a national credit reporting system. These advances have allowed lenders to more accurately gauge credit risk with less reliance on benchmarks like downpayments.

Lenders have discovered (and studies have supported) that a borrower’s credit profile is a much better indicator of the performance of a loan than is the amount of the downpayment. The national credit information system preserved under the Fair and

Accurate Credit Transactions Act of 2003 allows lenders to efficiently access a borrower's credit information and effectively evaluate risk.

Current theory indicates that the driver of default is not equity. That is, a borrower does not look at how much equity they have in their home each month and decide whether or not they're going to make their mortgage payment or how hard they will work to avoid default. Rather, the default option is driven primarily by whether or not they have the willingness and ability to satisfy the debt. The ability to pay is affected by income, and the willingness to pay is determined by credit history.

This confirms an intuitive truth: a borrower's willingness and ability to pay a mortgage depends much more on their character and resourcefulness, and less on how much wealth they bring to the closing table. Given this fact, it is time to address the downpayment challenge as an obstacle that prevents good borrowers from becoming good homeowners.

In looking to remove the downpayment as an obstacle to homeownership, MBA is not suggesting a "homeownership at all costs" strategy. Rather, we are advocating a targeted attempt to remove the downpayment obstacle and close the homeownership gap among races and economic classes.

While the FHA program authorized under H.R. 3755 will not be the first no-downpayment mortgage product on the market, MBA believes it will be the most broadly applied and will reach minority and low- and moderate-income populations at the highest rates, without strict geographic or credit scoring criteria.

As mentioned previously, FHA has a history of implementing innovative mortgage products, tested with the backing of the Federal government, and eventually adopted by the private sector. It is important to emphasize that this history of innovation is undertaken at no cost to the taxpayer. FHA funds the operation of its mortgage insurance programs from the revenues it charges for use of its insurance.

FHA insurance is the appropriate means to close the homeownership gap among minorities and low- and moderate-income families.

FHA's single-family programs serve minorities at higher rates than the market at large. In 2002, more than one third of all FHA borrowers were minorities. FHA served African-American and Hispanic families at approximately three times the rate of the general market. During that year, 13.3% of FHA's borrowers were African-American compared with 4.6% in the general market. Likewise, 19.1% of FHA's borrowers were Hispanic, compared with 6.7% in the conventional market.

A significant number of FHA borrowers are low- and moderate-income borrowers. In 2002, over 57% of FHA's borrowers had an annual income under $50,000, while 26.6% of conventional borrowers earned less than $50,000.

FHA's programs are active in "underserved" areas of the country at much higher rates. A 1999 study by HUD's Office of Policy Development and Research showed that 40.5% of FHA's loans were made in "Underserved Areas."

Plainly put: FHA reaches the people and places necessary to bridge the homeownership gaps.

MBA supports H.R. 3755 as an important innovation for FHA. We specifically support H.R. 3755 for three reasons: it will serve those families who, but for a wealth constraint, would otherwise make good borrowers; it will serve these families without cost to the taxpayers; and it will help improve FHA's financial health.

It is MBA's understanding that H.R. 3755 authorizes FHA to insure mortgages up to 100% of the appraised value or purchase price of a home, whichever is less. We further understand that it is FHA's intention to allow borrowers to finance the Mortgage Insurance Premium (MIP) and closing costs into the loan amount. Additionally, we understand that FHA will limit the program to first-time homebuyers, require homeownership counseling, and charge a slightly increased MIP to ensure the program operates without a negative impact on FHA's funds. We further understand that there will be no reduction in FHA credit standards.

Given the above understanding, MBA is confident that the FHA zero downpayment product will allow good borrowers to become good homeowners. In many communities, housing prices are rising faster than incomes. If a borrower can afford the monthly payment and is a good credit risk, why should they be penalized by housing prices that keep rising faster than their income? Furthermore, the funds borrowers are able to save by not making a downpayment might be better held by that borrower as a contingency reserve after they close. The 3-5% equity position in a new home does little good for new homeowners if emergencies arise.

The benefits of FHA's Zero Downpayment program will be realized without cost to the taxpayers. The higher MIP has been calibrated to cover expected losses under the program. FHA has a solid record of accurately adjusting its insurance premiums to ensure it can deliver its programs in a fiscally sound manner. Since 1992, FHA's Mutual Mortgage Insurance Fund (MMIF), which will finance the Zero Downpayment program, has exceeded the Congressionally-mandated capital ratio. MIPs that were high in the early 1990s have been gradually reduced, with FHA maintaining a positive revenue position. Currently, FHA has over $22 billion "on account" at the U.S. Treasury to cover losses it may incur on its current portfolio.

Even with the higher foreclosure and claim rates FHA is currently experiencing due to the recent recession, MBA believes that FHA currently has ample resources to cover these expenses.

MBA believes, in fact, that FHA's financial position will be improved under this program.

Over the past several years, certain nonprofit corporations have, while loosely following FHA regulations, effectively offered zero downpayment loans to FHA borrowers. HUD's Office of Inspector General and an independent study have expressed concerns loans closed under these programs have a significantly higher default rate and can tend to have inflated property values. At the same time, FHA is unable to compensate for the additional risk with these loans by charging a higher MIP.

H.R. 3755 would empower FHA to reach the same borrowers served by these programs, but at less cost to the borrower and to FHA. Borrowers would not find themselves buying homes where the seller has adjusted the price of the home due to a particular financing mechanism employed to fund the downpayment. FHA can charge a higher MIP and compensate for the additional risk. MBA believes that loans closed under the Zero Downpayment program would perform better than some of the downpayment assisted loans FHA is currently insuring.

The fact is, with H.R. 3755, FHA could reach additional minority and low- and moderate-income families than it does today, and do so in a financially responsible manner.

President Bush launched the administration's "Blueprint for the American Dream" Initiative in 2002, with its stated goal of creating 5.5 million new homeowners by the end of the decade. MBA has been a strategic partner with HUD in working toward the fulfillment of this goal. We believe that the Zero Downpayment program proposed in H.R. 3755 will be an important tool for FHA to address the needs of even more minority homebuyers.

MBA applauds Congressman Tiberi for introducing this bill and demonstrating his commitment to closing the homeownership gap. Once again, thank you for allowing MBA to testify today.

We would be happy to furnish any additional needed information to the committee as it considers this bill.

Thank you.